U.S. Flue-Cured Tobacco Update

Blake Brown, North Carolina State University
February 1, 2011
www.tobaccogrowerportal.org

Market Situation

According to USDA, U.S. flue-cured tobacco harvested acreage was estimated at 211,000 down 13,000 acres from 2009. Acreage had declined to a low of 174,500 in 2005 before it climbed to 224,000 in 2009. Estimated 2010 average yield per acre was 2,148 pounds down from 2,346 pounds in 2009.The 2010 U.S. flue-cured crop production estimate was 453.08 million pounds, down 15% from 526.4, million pounds in 2009. According USDA-NASS North Carolina acreage was 166,000 acres, down 8,000 acres from 2009. Production in North Carolina was estimated at 348.6 million pounds, down 16 % from 2009. The North Carolina 2010 crop was reported to be spotty and late in many areas. Most farmers reported lower quality with some saying this was their worst crop ever. This was primarily due to dry weather which lowered average yields substantially. The Center for Tobacco Grower Research (CTGR) (www.tobaccogrowerresearch.com) reported results from a 2010 phone survey of 154 flue-cured growers in which 36% of growers responding considered the overall quality of their 2010 crop “average,” 30% considered it “below average,” and 13% considered it “poor.”

According to the CTGR 2010 phone survey 43.5% of growers surveyed reported a reduction in their 2010 contract relative to 2009. Of those reporting that their 2010 contract was cut, they reported that, on average, their contract was cut 21 %. About 32% of the 154 flue-cured growers surveyed indicated that their contract pounds were unchanged for 2010 and slightly over 20% reported an increase in pounds under contract. If the survey is representative of flue-cured growers, then it implies a reduction in contracted pounds overall of 7-8%. Other reports from industry and farm groups indicate that primary contracts were down around 20%. The survey may have included secondary contracts causing the reduction in contract pounds reported to be lower than 20%. Also some farmer lost contracts which may not have been reflected in the survey results.

Expectations were that domestic manufacturers would need less tobacco due to increased cigarette taxes and in anticipation of implementation of FDA regulation. However, the cut backs and closures of some buying stations by the largest export customer were unexpected. This appeared to be a global decision perhaps reflecting declines in cigarette consumption in developed country markets around the globe. At the same time another export buyer opened a processing facility in Virginia. Purchases by this buyer may have been up partially offsetting decreased purchases by other buyers.

With the 2010 crop down only 15 percent, but contracted volume perhaps down 20 percent, excess supply may have been problematic for the 2010 market. This combined with quality problems are likely reasons for depressed 2010 crop prices. Farmers reported lower prices mainly due to receiving lower grades for tobacco than last season. Some growers sold a portion of their crop via a secondary contract and a few growers sold their entire crop in this manner. The secondary contracts were with leaf dealers usually at a lower price than primary contracts. Some farmers sold a portion of their crop via silent auctions. Prices in the auctions were reported to be substantially lower than contract prices. It appears this accounted for only small portion of production.

Table 1: U.S. Flue-Cured Tobacco Production, 2004 to 2010, in million pounds.

	Florida	Georgia	North Carolina	South Carolina	Virginia	U.S. Total
2004	9.8	46.7	344	63.4	57.6	521.5
2005	5.5	27.8	273.9	39.9	33.7	380.8
2006	2.9	30.1	324.0	48.3	42.0	447.2
2007	n/a	39.8	376.8	46.1	41.0	503.8
2008	n/a	33.6	384.7	39.9	41.0	499.2
2009	n/a	28.0	417.6	38.8	41.0	525.4
2010	n/a	27.4	348.6	36.0	41.1	453.1

(Source: USDA, NASS, Crop Production Report, January 2011)

Flue-cured tobacco market prices are difficult to estimate since all flue-cured tobacco is grown on contract. However USDA-NASS reported an average price per pound of $1.754 for the 2009 crop. Prices are expected to have been lower for the 2010 crop. The average price may have been as low as $1.70 per pound.

USDA no longer tracks world tobacco production. Global flue-cured tobacco production was expected to be 9.9 billion pounds in 2010, up almost 4% from 2009 according to Universal Tobacco Company's November 3, 2010 issue of "World Leaf Production." Production was up in China for the second consecutive year and estimated to be about 5.42 billion pounds. Brazilian flue-cured production (the chief competition to U.S. flue-cured) declined from 1.340 billion pounds in 2009 to 1.25 billion pounds in 2010. The declines in both Brazil and the U.S., the two primary exporters of premium flue-cured tobacco, indicate a drop in supplies of premium style flue-cured. This decline in supply was in part due to weather, but mayalsp beem due to declining demand in developed country markets such as the U.S. and Europe.

Total use of flue-cured tobacco (use by domestic manufacturers plus exports) was down for the 2009 -2010 marketing year. This was due to lower domestic use. Exports rose from a low of 188.6 million pounds in the 2005-2006 marketing year to 305 million pounds in the 2007-2008 marketing year. Exports were about the same in the 2008-2009 marketing year at 304 million pounds. Exports of unmanufactured flue-cured tobacco are down slightly for the 2009-2010 marketing year at 303 million pounds. The low value of the dollar has favored exports. With lower demand from both domestic and export buyers for the 2010 crop, both domestic use and exports may be lower for 2010-2011.

A global trend in restrictions on flavorings in cigarettes could cause a switch toward Virginia style cigarettes that contain more flue-cured tobacco. This could partially mitigate the impact of declining demand in developed countries due to increased regulations and restrictions, increased taxes and continued health concerns. Much uncertainty remains as a result of both FDA and the World Health Organization Framework Convention on Tobacco Control regulations.

Table 2: Flue-Cured Tobacco Production , Stocks, Supply and Disappearance (farm sales weight million lb)

Marketing Year	Beginning Stocks	Production	Total Supply	Ending Stocks	Total Use	Exports	Domestic Use
2004-2005	822.8	499.3	1,322.2	796.0	526.2	188.6	337.6
2005-2006	796.0	380.9	1,176.9	604.0	572.8	258.4	314.4
2006-2007	604.0	446.5	1,050.5	493.2	557.3	247.0	310.3
2007-2008	493.2	503.8	997.0	396.8	600.2	305.0	295.3
2008-2009	396.8	499.2	896.0	360.3	535.6	304.2	231.5
2009-2010	360.3	525.4	885.7	398.8	486.9	303.1	183.7

(Source USDA-AMS Tobacco Stocks as of Octoberl 1, 2010. TOB-210. November, 2010. USDA-FAS.GATS)

FDA Update

Thus far in implementing the *Family Smoking Prevention and Control Act* FDA has established a Center for Tobacco Products, set up a Tobacco Products Scientific Advisory Committee, banned flavorings, with the exception of menthol, in tobacco products, banned designations such as "Light," "Mild," or "Low" and issued new warning labels, proposed graphic warning labels, begun a study on whether to restrict or ban menthol use in cigarettes, developed a list of harmful constituents in cigarettes, required tobacco product manufacturers to report all ingredients, initiated a study by the National Academies of Science on reduced risk tobacco products, and begun levying fees to pay for regulation of tobacco products. During 2011 the FDA Tobacco Products Center is expected issue regulations for graphic warning labels on cigarettes, issue a ruling on menthol use in cigarettes, and establish pesticide limits on tobacco. At some point in the future FDA will begin requiring manufacturers to test for harmful constituents and may regulate the levels of certain harmful constituents.

While tobacco is not regulated directly at the farm level, regulations setting pesticide limits in tobacco and regulations regarding harmful constituents will impact the farm via requirements passed down by manufacturers. Reductions in demand due to increased regulation are already manifested in lower domestic use by U.S. cigarette manufacturers. Due to the uncertainty surrounding FDA regulation of tobacco products manufacturers are making very conservative business decisions. This includes purchases of tobacco since manufacturers want to minimize stocks of tobacco that might not meet as yet unknown requirements under FDA.

2011 Production and Prices

At writing only a couple of buyers had given indications of prices for the 2011 crop. However, export demand seems to be stronger this year relative to 2010. Indications are that at least three traditional foreign buyers will increase purchases. The total increase from just these three buyers could mean a 25-30 million pound increase in contracted pounds. Even though demand fell for the 2010 crop, a smaller than expected supply of flue-cured last year due to poor 2010 U.S. and Brazilian crops may have bolstered demand for tobacco in 2011. As such this could be a one year increase rather than a permanent increase. Other buyers were in the process of signing contracts with growers at the time of writing

The big news in the U.S. tobacco market is the emergence of a new buyer offering contracts for a supposed 100 million pounds of flue-cured tobacco for export to China. The China National Tobacco Corporation and the State Tobacco Monopoly Administration have indicated that they have no knowledge of the new buyer. This leaves growers wondering to whom the new buyer will export tobacco. The new buyer has already signed contracts for substantial quantities of tobacco. The most important unanswered questions are whether or not this new demand is real and whether it will persist beyond 2011.

Could the U.S. produce an additional 100 million pounds of flue-cured? The U.S. produced 526 million pounds of flue-cured on 224 thousand acres in 2009; the largest acreage since 2004. Yields were above average in 2009. With 224 thousand acres of production and the 5-year average yield of 2,226 pounds per acre, production would be 498 million pounds. Quantity demanded at contract prices going into the 2010 season may have been about 460 million pounds. Suppose demand at current prices from traditional buyers is up 30 million pounds for 2011. Under this scenario production of 490 million pounds would be needed to satisfy demand from traditional buyers.

Is there curing capacity beyond 224 thousand acres? Some 2009 growers lost contracts and dropped out of tobacco. According to the Center for Tobacco Grower Research (CTGR) 43 percent of growers in 2010 experienced an average reduction in contract pounds of 21 percent. So the important questions are 1) was there excess capacity in 2009, and 2) how much capacity was lost in 2010? While the answer is uncertain, the 224,000 acres grown in 2009 is likely the upper limit of current capacity. Unless there is evidence that the 2011 increase in demand is permanent, it is unlikely that new equipment will be manufactured or purchased to increase current capacity.

Convincing growers to grow more tobacco is not just a question of capacity. Strong commodity prices for corn, soybeans and cotton make them viable alternatives for tobacco. At writing 2011 crop cotton could be booked for around $1 per pound in North Carolina. While some cotton producing areas have limited gin capacity for expansion, North Carolina has much unused gin capacity, placing NC farmers in a good position to increase cotton production. The 5-year average yield for NC cotton is 844 pounds per acre. If farmers book cotton at $1 per pound, then potential revenue per acre is $844. Operating costs per acre are around $525 and land rent around $100. This leaves a potential $244 per acre return to equipment and management for growing an acre of cotton. Using the 5-year average yield for tobacco of 2,226 pounds per acre and a price of $1.75 per pound means expected revenue on an acre of tobacco is about $3,895. Using an estimate of operating costs per acre of $2,750 and land rent of $100 gives a return to management and equipment per acre of flue-cured of $1,045. This means that 43 acres of cotton will yield an equivalent return to management and equipment as 10 acres of tobacco. The question for eastern NC growers that have equipment to grow extra tobacco or cotton will be would I rather grow an extra 43 acres of cotton or an extra 10 acres of tobacco?

Obviously piedmont growers may not have such opportunities so expansion of tobacco production may be a question of do I have extra curing capacity and can I get enough labor to grow more tobacco? H2-A labor wage rates will increase around $2 per hour this season. The labor situation also decreases the attractiveness of expansion of tobacco. Buyers who are requiring that tobacco be grown free of maleic hydradzide (MH) or other special requirements may have trouble getting the pounds they desire unless prices paid reflect the higher cost and management requirements of this tobacco.

With limited capacity to expand and viable alternatives to tobacco production in eastern NC, competition among buyers for the 2011 flue-cured crop could be intense. This logically should bolster prices. Some buyers have already indicated that they will pay higher prices for the coming crop. Indications are that other buyers are offering prices similar to those offered in 2010 contracts. Whether prices are higher for the 2011 season is yet to be seen. Further we are still waiting to see what quantities domestic buyers will want this year amid another year of uncertainty with FDA regulation.

References

Center for Tobacco Grower Research. "2010 Tobacco Grower Phone Survey." www.tobaccogrowerresearch.com

FDA Center for Tobacco Products. http://www.fda.gov/tobaccoproducts/default.htm

USDA-Agricultural Marketing Service. "Tobacco Stocks as of April 1, 2010." TOB-210. June, 2010.

USDA-Foreign Agricultural Service. GATS (Global Agricultural Trade System Online). www.fas.usda.gov/gats/default.aspx

USDA-National Agricultural Statistics Service. *www.nass.usda .gov*

Universal Leaf Tobacco Company. "World Leaf Production." August 3, 2010.Accessible at www.universalcorp.com/Reports/SelectReport.asp?ID=725&Menu=Tob.